



The Math on PPP Loan Forgiveness – Part 2



May 21, 2020

FTBA Members:

- Herman Lazzara HLazzara@rgcocpa.com
- Jon Stein JStein@rgcocpa.com
- Kevin Bass KBass@rgcocpa.com

Feel free to email or call us at 813-875-7774

INFORMATION SUBJECT TO CHANGE BASED ON FURTHER
GUIDANCE PROVIDED BY SBA OR OTHER FEDERAL
AGENCIES.



Rule Sources

- Coronavirus Aid, Relief, and Economic Security (CARES) Act
 - <https://www.congress.gov/116/bills/hr748/BILLS-116hr748enr.xml>
- U.S. Small Business Administration Interim Final Rules (Yes, that's what it's called). Implements and provides guidance for Sections 1102 and 1106
 - <https://home.treasury.gov/policy-issues/cares/assistance-for-small-businesses>
- FAQs provided by SBA
 - <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>
- PPP Loan Forgiveness Application
 - <https://home.treasury.gov/system/files/136/3245-0407-SBA-Form-3508-PPP-Forgiveness-Application.pdf>

Forgiveness Application Needs

- PPP Loan Amount and disbursement date
- Disclosure if EIDL Advance received.
- Employee counts: time of loan app and time of forgiveness app
- Disclosure of Pay frequency schedule
- Checkbox for \$2 Million borrower level (affiliates included)
- More Reps and Certifications signed by borrower.
- 6 year document retention requirement.

Requesting Forgiveness (Wait until after June 30th)

- **Submit Loan Forgiveness Application**
 - Expiration Date is 10/31/2020
 - Submit the PPP Loan Forgiveness Calculation Form
 - Submit PPP Schedule A and Substantiation
- **Begin to gather substantiation needed now.**
- **PPP Schedule A Worksheet is not required to be submitted, but must be completed regardless.**
- **PPP Borrower Demographic Information is optional**

8-Week (56 days) Covered Period

- Covered Period: Day 1 = same as PPP Loan Disbursement Date; runs for 56 days. Ex. Begins on a Monday, ends on a Sunday.
- Alternative Payroll Covered Period:

Borrowers with Bi-Weekly (or more frequent) payroll schedules may elect to adjust their Covered Period to begin on the first day of their next Pay Period.

 - Borrowers who make this election must apply the Alternative Period in calculations where referenced.
 - If elected, applies to Salary and FTE calculations.
 - Does not apply to Non-Payroll Costs. Creates two separate measurement periods.

Forgiveness Amount

Forgiveness Amount is defined as the LESSER OF:

- PPP Loan Amount,
- Eligible Payroll Costs / 75% (eliminates Cliff), OR
- Total Eligible Payroll and Non-Payroll Costs reduced by the Total Salary/Hourly Wage Reduction multiplied by the FTE Reduction Quotient

Eligibility

“Costs incurred AND payments made” (Sec. 1106(b)) during the period changed...

Flexibility Added: Changed to “incurred OR paid” on Forgiveness Calculation Instructions for Line 1. A play on words may have big impact.

- Payroll Costs
 - Eligible for forgiveness for PR costs paid AND PR costs incurred during the 56 day Period.
 - Payroll costs are “paid” on the date paychecks are distributed or the borrower originates an ACH credit transaction (even if earned prior to covered period?).
 - Payroll Costs are “incurred” on the day the E/E’s pay is earned.
 - Wages earned through final day of covered period can be paid after covered period on or before the next regular payroll date. The above could mean two independent tests. Guidance here would clarify.
- Non-Payroll Costs (cannot exceed 25% of the total forgiveness amount)
 - Covered Rent, mortgage interest and Utility payments must be paid during covered period (even if incurred prior to...) OR,
 - Incurred during covered period and paid before the next regular billing date
- Count Payroll and Non-Payroll Costs BOTH Paid and incurred only once.

Payroll Cost Eligibility

- Decide on Covered Period or Alternative Covered Period
- Day 1 – Payroll paid on or after Day 1 that includes wages earned prior to Day 1 – IS THIS ELIGIBLE?
- Day 56 – Include hours worked through this day even if paid after, but no later than next pay period.
- \$100,000 cap as pro-rated (\$15,385 for 8 weeks).

Payroll Cost Eligibility

- Non-Cash Compensation PR Costs allowed for:
 - ER contributions for EE health insurance
 - ER contributions to EE retirement plans
 - ER state and local taxes assessed on EE comp.

Nothing on the application indicates “Owner-Employees” are specifically excluded.

- Self-employed individuals and Partners could be excluded since they are not “employees”.
- Provides for unfair treatment depending on business structure.

Owner's Compensation

- PPP Schedule A separates Owner's Comp from other employees
 - Owners are not included in Table 1 or 2
- Amount capped at lower of \$15,385 for covered period OR 8-week equivalent of 2019 compensation.
 - Prevents giving yourself a raise / bonus to cover costs.
- Owner Employees will not enter into the calculation of the FTE reduction or reduction in wages.
- It is not clear if attribution rules apply here for related parties on payroll.

Non-Payroll Cost Eligibility

- Covered Mortgage Interest only; Not Principal; debt must be in place before 2/15/20 – covers real or personal property debts
 - What is Personal Property for this purpose?
 - What is a mortgage for Personal Property? Autos, Inventory?
- Covered Rent obligations in force before 2/15/20 for real or personal property. “pursuant to lease agreements”.
- Covered Utilities for services beginning by 2/15/20 includes electricity, gas, water, transportation, telephone, or internet access.
- Besides Pre-paid Interest being specifically disallowed, are other Prepayments allowed under “paid” or “incurred” model? Need guidance.

PPP Schedule A Worksheet

- **Table 1** – Lists E/E's who were employed during Covered period AND paid < \$100K annualized rate for ALL pay periods in 2019 OR were NOT employed at any point in 2019.
 - Removes fears about salary reductions for former EE's not paid during Covered period thus, not paid 75% of prior period.
 - Very Borrower Friendly. Only a reduction of annualized salary or pay rates.
 - Average FTE – each single EE capped at 1.0 for 40 hour week.
 - Salary / Hourly Wage Reduction - > 25% only
 - See Instructions for PPP Sch. A Worksheet Pg. 7-8 Steps 1-3 to determine reduction for each employee listed.

PPP Schedule A Worksheet

- **Table 2** –Lists E/E's who were employed during Covered period AND paid > \$100K annualized rate for ANY pay period in 2019.
 - List Cash Compensation paid or incurred during covered period or Alternative Period; capped at \$15,385 per E/E.
 - Average FTE – capped at 1.0 for 40 hour week.
 - Salary / Hourly Wage Reduction – N/A

Salary / Hourly Wage Reduction

- Compare EACH employee making less than \$100,000 annually (Table 1) and compare their annual salary OR hourly wage for the 8-week period against 1st quarter annualized wages. Follow Instructions for PPP Schedule A Worksheet to Line 5 of PPP Loan Forgiveness Application.
- Employee #1 – determine avg. annual salary based on avg. wage rate for 1Q 2020 by pay period. Ex. Q1 Pay = \$10,000 / 13 weeks = \$769.23 / wk
- On a 52 week year - \$40,000 annually
 - OT Counts for this purpose
- Employee #1 – 8-week period Pay = \$4,500 / 8 weeks = \$562.50 / wk
- On a 52 week year - \$29,250 annually
- Divide \$29,250 / \$40,000 = 73.125% = Fail for this employee
- Reduce amount of Loan forgiven dollar for dollar by \$115
 - \$40,000 x 75% = \$30,000 - \$29,250 = \$750
 - \$750 x 8 = \$6,000 / 52 = \$115

Check box on PPP Schedule A Line 3 if NO Reductions and enter “0” on Line 3.

Salary/Hourly Wage Reduction Safe Harbor

If Borrower meets Circumstances, reduction of Loan Forgiveness is reduced:

1. Applies only if annual salary OR hourly wage is reduced from 2/15/20 – 4/26/20 and,
2. That rate is restored by 6/30/20; by employee, no cliff effect. Is this just for a moment in time leading to 1-day raises to meet the safe harbor? Guidance please...

Must complete the PPP Schedule A worksheet to determine based on instructions provided.

FTE Reduction Quotient

DEFINED: Total Average FTEs (Tables 1 + 2)/ Average FTE during borrower's chosen reference period (not to exceed 1.0)

Average FTEs (for each employee) per week for 8-week period. Enter on PPP Schedule A Worksheet (Tables 1 & 2).

Then, choose your reference period; The Lesser of:

The avg. FTEs per week – 2/15/19 – 6/30/19 OR

The avg. FTEs per week – 1/1/20 – 2/29/20

Enter on Line 11 of PPP Schedule A.

FTE Reduction Quotient

FTEs equal the avg. number of employees you have over a given period

Divide # of hours by # of weeks. 40 Hour work week confirmed in Instructions. Max amount per E/E is 1.0.

Ex. $8,160 \text{ hours} / 8 \text{ weeks} / 40 \text{ hrs} = 25.2 \text{ FTEs}$

- Round to nearest tenth
- Simplified method allowed for 1.0 at > 40 hours or 0.5 for < 40 hours
 - Choose the option that maximizes your Quotient.

NOTE: The FTE Quotient comes after reduction for Salary/Hourly Wages, thus the Salary/Hourly Wage reduction gets reduced proportionately by the FTE Quotient. This is borrower favorable.

FTE Reduction Safe Harbor

If Borrower meets both Circumstances, reduction of Loan Forgiveness is reduced:

1. If the FTEs drop from 2/15/20 – 4/26/20 and,
2. The reduction is restored by 6/30/20 to 2/15/20 levels.
Is this just for a moment in time? Will June 30th be the largest “new hire” day of the year? Guidance...
3. Safe harbor is not met at all if 2/15/20 FTE levels are not fully restored. Cliff effect.

FTE Reduction Second Simple Safe Harbor

PPP Schedule A provides after Line 10 a checkbox to allow a borrower to skip the complex math for FTEs if they have NOT reduced:

1. The Number of Employees and
2. Average paid hours

“between” 1/1/20 and the end of the Covered Period. It is not clear if this is a 2 day test or provides for zero volatility throughout the range...

FTE Reduction Exceptions

Borrower's loan forgiveness is NOT reduced by FTE reductions in the following cases:

- Written re-hire offers made during covered period rejected by E/E.
- Any E/E fired for cause
- Any E/E who voluntarily resigned
- Any E/E who voluntarily requested a reduction in hours.
- What it doesn't tell us is how much FTE weight one of these exceptions will carry. Guidance...

The Math...The Application

FACTS...For example

1. Amount Used for Payroll Costs -	\$ 71,000
2. Amount used for other eligible Costs -	\$ 24,000
3. Total Salary/Hourly Wage Reduction	<u>\$ (2,500)</u>
4. Application – Line 6	\$ 92,500
5. FTE Reduction Quotient	0.9
6. Loan Amount	\$ 100,000

The Math...The Application

Example continued...

Forgiveness Amount is the LESSER OF:

Line 8 – Modified Total = $\$92,500 \times 0.9 = \$83,250$

Line 9 – PPP Loan Amount = $\$100,000$, or

Line 10 – PR Costs = $\$71,000 / 75\% = \$94,667^*$

- - Would be the Forgiveness amount if Wage and FTE safe harbors were met.

Taxation of Forgiven Debt

- Cancelled debt is generally taxable however,
- CARES Act Section 1106(i) excludes from gross income the debt forgiven under Section 1106(b).
- IRS Released Notice that Code Section 265 disallows deductions otherwise allowable which is allocable to income exempt from tax.
- Members of Congress have vowed to fix the IRS ruling legislatively to allow deductions. Stay tuned.